

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

IN RE:)	Case No. 99-32070
)	Chapter 7
FRANK H. DAVIS, II,)	
)	
Debtor.)	
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)	
TOMKINS INDUSTRIES, INC., dba)	Adversary Proceeding
MALTA DIVISION,)	No. 00-3014
)	
Plaintiff,)	
)	
)	
v.)	FINDINGS OF FACT
)	AND
FRANK H. DAVIS, II,)	ORDER OVERRULING OBJECTION
)	TO DISCHARGE
Defendant.)	
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In this action, Plaintiff Tomkins Industries, Inc., dba Malta Division("Malta"), seeks some \$340,449.19, plus accrued interest from Defendant/Debtor Frank H. Davis ("Davis"), based upon a personal guaranty debt. Malta also seeks a ruling that this debt was incurred through Davis' use of a false financial statement making it nondischargeable in his bankruptcy case. 11 U.S.C. § 523(a)(2)(B).

Davis denies that the document he gave Malta constituted a financial statement within the meaning of the statute; that it was false; that he intended to deceive Malta; or that Malta reasonably relied on it to its detriment.

A trial was conducted on June 19, 2001.

Based upon the evidence presented and in light of the arguments made, the Court enters the following:

FINDINGS OF FACT

1. Davis is the Chapter 7 debtor in this bankruptcy case filed on September 1, 1999. Before bankruptcy, Davis owned and operated Charlotte Door Company, Inc. ("Charlotte Door").

2. Charlotte Door was a Malta windows dealer. From 1991 through 1996, Charlotte Door bought from Malta on open account. However, by October, 1996, Charlotte Door had run up a debt to Malta in excess of \$226,000. Malta was concerned, and opened negotiations with Davis/Charlotte Door about repayment options. These included having Charlotte Door secure the debt and/or Davis personally guaranteeing the obligation. These negotiations continued through the Winter and into the Spring of 1997.

3. By April, 1997, Charlotte Door was still seriously delinquent, and Malta was threatening to shut off credit to the company. This would have killed Charlotte Door, as Malta supplied about 85% of the products which Charlotte Door sold.

4. At this point a deal was finally reached, and memorialized in an Agreement dated May 1, 1997. Under this agreement, Malta agreed to continue to credit sell to Charlotte

Door. Charlotte Door gave Malta a first priority security interest in its assets to secure Malta's debt; agreed to make monthly payments on Malta's outstanding debt; and agreed to timely pay for all new shipments. For his part, Davis personally guaranteed Charlotte Door's debts to Malta.

5. With this Agreement in place, Malta continued shipping products to Charlotte Door.

6. Ultimately, the workout failed. Over the next sixteen months, Charlotte Door failed to significantly reduce its outstanding debt to Malta. Eventually, it stopped paying Malta for new product. The company shut its doors in September, 1998.

7. In December, 1998, Malta brought suit against Charlotte Door and Davis in Mecklenburg County Superior Court seeking to collect its outstanding debt. This action proceeded to the summary judgment stage. With a motion by Malta pending, Davis then filed bankruptcy. This stayed Malta from pursuing Davis in the state court suit. Summary judgment was subsequently entered against Charlotte Door for some \$340,449.00.¹ The full judgment amount plus accrued interest is still outstanding.

¹The judgment of the Mecklenburg County Superior Court dated September 16, 1999 in *Tomkins Industries, Malta Division v. Charlotte Door Company, Inc., et. al.*, Case No. 98 CVS 18013 was for \$271,652.78 principal, plus interest through the Complaint date of \$ 9,841.52, interest through the judgment date of \$16,730.74, interest at the legal rate thereafter, and attorney's fees of \$42,224.15.

8. Malta followed Davis into this Court, filing this action on January 13, 2000.

9. That Davis owes Malta based upon his personal guarantee is not really contested. The Court finds a prepetition debt in amounts stated in the State Court judgment, again with accrued interest.

10. Rather, this fight is about dischargeability and a list of personal assets/liabilities which Davis gave to Malta prior to their agreement.

11. At some point during the negotiations leading up to the Agreement, Davis gave Malta a handwritten list of personal assets and liabilities (hereinafter the "Statement"). The Statement shows Davis with a net worth of \$625,000 as of December, 1996.

12. As financial statements go, this was not a very impressive document. First, the Statement given to Malta is a photocopy and not an original. Second, while Malta has its own financial statement form which it often uses, this document was done on a preprinted First Citizens Bank form. Third, the entries on the Statement -- these assets and liabilities -- were handwritten, in pencil, by Davis. Finally, the form is unsigned.

13. Malta says this Statement was materially false or misleading for two separate reasons: First, the list purports to be only Davis' personal statement. In reality, many of the assets (and a few of the debts) listed are either Davis' wife's property or held jointly by the two. Second, Malta says that several assets are substantially overvalued in the statement. Malta says it relied on this statement to its detriment in entering into the Agreement and continuing to extend credit to Charlotte Door after May, 1997.

14. The Court agrees with Malta as to the asset values. When one compares the Statement to Davis' Bankruptcy Schedules, it is clear that the values of several assets are inflated in the Statement²:

Asset	Statement	v. Schedules
Residence	\$470,000	--> \$349,000
Insurance ³	\$ 8,000	--> \$ 3,470
Furniture	60,000	--> \$ 2,000+/-
Six vehicles	\$83,000	--> \$18,300

²Alternatively, one could conclude that Davis filed false Bankruptcy Schedules. However, this would not aid him in this action. Bankruptcy schedules are signed under penalty of perjury. As such, giving a false oath in connection with a bankruptcy case is a basis for denying the debtor's discharge (11 U.S.C. § 727(a)(4)(A))), and is a felony. 18 U.S.C. § 152(a)(4)

³ Cash surrender value.

Excluding property which Davis sold before bankruptcy and spousal property, the Statement appears to overvalue Davis' assets at least \$125,000 and perhaps by as much as \$200,000.

15. As to Malta's claims that Davis misled it by including joint and spousal property in Davis' personal Statement, it is true that the Statement does not suggest that family assets are included. On its face, the Statement shows the borrower as being "(FH) Brooke Davis."

16. The inclusion of these co-owned or spouse-owned assets changes Davis' financial portrait. For example, the Statement makes Davis' house appear to have substantial equity--\$386,000. This suggests that most of this equity (after exemptions) would be available to an individual creditor such as Malta. However, in reality this house is entireties property--owned by Davis and his wife. Under North Carolina law, such property is exempt from an individual creditor's claims. To a lender like Malta, it would have no value.

17. In like fashion, the Statement lists \$18,900 of stock. Actually, these stocks are either jointly owned (meaning Davis' interest is only one half stated value) or are entirely the property of Ms. Davis. Finally, in the Statement, Davis listed \$18,000 of jewelry. Actually, all but one watch (\$1,200) was owned by Ms. Davis.

18. According to Davis, however, Malta was aware that this was a joint statement. He says that when he sent Malta the Statement he told Jeff Bergfeld, Malta's (then) credit manager, that the Statement included his wife's property.

19. There is a problem in the evidence on this point. The negotiations leading up to the Agreement were conducted by Davis (for himself and Charlotte Door) and by several different Malta employees, including David Bird (President); Bergfeld; Gary Dodez; and Malta's area sales rep, Steve Love. However, except for Davis, none of these persons testified at trial.⁴ The former Malta employees who did testify--interim credit manager Jeanette Cordray and Bergfeld's successor, Larry Mackowiak, were not present during these negotiations.⁵ Apart from the fact that the Statement was in its file, Malta had no evidence to contradict Davis' statement.

20. Although his memory was somewhat hazy, Davis otherwise appeared a credible witness. And with no contrary evidence, the Court will accept his testimony on this point. Malta was told

⁴ Bergfeld left the company just after the Forebearance Agreement was inked. Bird left the company just prior to Malta's shutdown in April, 2001.

⁵ After Bergfeld left Malta, Cordray, a Malta credit person, took over as interim credit manager. She had no real involvement with Davis/Charlotte Door. Mackowiak came in at the end of May, 1997 and was credit manager through the time Charlotte Door closed.

before entering into the Agreement that Davis' Statement included family assets.

21. In any case, in entering into the Agreement, it appears Malta gave no thought to Davis' personal assets. Certainly, nothing in this record suggests that the Statement was required by Malta as a precondition to this workout.

22. For example, in negotiating this deal, the parties made a series of offers and counteroffers, in writing. The negotiations and sticking points are well documented. Despite this, none of their correspondence mentions Davis' personal finances or asks for his financial statement. While Malta sent Davis a personal guarantee agreement, no financial statement was ever requested. Apart from the statement itself, there is nothing in Malta's file referencing this document.

23. This lack of reliance appears in other contexts. While the Agreement contained a merger clause, it makes no mention of a personal financial statement as being a condition of the deal. Malta's credit department does not do a credit check on Davis, although it has this capability. After the deal is made, Malta never asks Davis for an updated financial statement. And until this litigation was filed, Malta did not realize that the Statement in its file was an unsigned photocopy.

24. In fact, the first time that Davis' personal assets were discussed is in early December, 1997. On December 1, 1997, Davis writes Malta to say that Charlotte Door is having a slow month and can't make the November payment. He also tells Malta that he personally cannot contribute this month to the company (apparently he has been doing so). He asks Malta for its forbearance. He also asks for a reply.

25. This comes quickly. Malta's new credit manager, Larry Mackowiak has a face-to-face meeting with Davis. What is said in this meeting is disputed. Davis says that Mackowiak, who is looking for a payment, asks Davis about his personal assets listed on the Statement. Davis says he tells Mackowiak that the Statement includes his wife's assets and jointly held property. Mackowiak denies this. He contends Davis never, ever told him that the Statement included family assets.

26. Based on what happens next, the Court believes Davis' account of these events. It is certain that immediately after this meeting, Mackowiak writes Davis and declares Charlotte Door's debt in default. In this letter, Malta, for the first time, demands that Davis' wife also personally guarantee its debt. This change in Malta's position, going from working with Charlotte Door to declaring a default and demanding a spousal

guaranty, makes it clear that Mackowiak had learned at that meeting that the Statement included Ms. Davis' assets.

27. Even though it has declared the Agreement in default, learned of Davis' true financial condition, and been told that Ms. Davis will not personally guarantee the debt, Malta continues to credit sell to Charlotte Door -- to the tune of another \$271,000. In fact, the entire debt sought to be collected by Malta in the State suit, and in this action, is based upon shipments made after December, 1997.

CONCLUSIONS OF LAW

1. Jurisdiction over this adversary proceeding is based upon 28 U.S.C. § 1334 and 28 U.S.C. § 157(a). This is a core proceeding under 28 U.S.C. § 157(b)(2)(I).

2. This is an action pursuant to 11 U.S.C. § 523(a)(2)(B). This Section excludes debts incurred through use of a false financial statement from a Debtor's bankruptcy discharge.

3. To prevail, Malta must show five things: a) a writing, b) which was materially false, c) concerning Davis' financial condition, d) on which it, Malta, reasonably relied in extending or renewing credit; and e) which Davis caused to be made or published with an intent to deceive Malta. Malta must demonstrate each element by a preponderance of the evidence. 11

U.S.C. § 523(a)(2)(B). *Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654 (1991).

4. Malta has demonstrated that this Statement was a writing concerning Davis' financial condition; that it was materially false; and that Davis intended this falsity, at least, in part. However, Malta has failed to meet its burden of proof of reasonable reliance on this document in extending or renewing credit. Therefore, the action fails.

5. Obviously, Davis gave Malta this written document in connection with the parties' 1996-97 negotiations. It also is clear that this document describes his financial condition.

6. Was the Statement a financial statement within the meaning of Section 523? Because it was unsigned and is a photocopy, not an original, Davis argues it is not.

7. The undersigned disagrees. One need not have a signed original. For Section 523(a)(2)(B) purposes, it is sufficient that Davis wrote, signed, or adopted the statement. *In re Kaspar*, 125 F.3d 1358, 1361 (10th Cir. 1997); *Investors Credit Corp. v. Batie*, 995 F.2d 85 (6th Cir. 1993) (financial statements submitted to closing constitute a writing); *Engler v. Van Steinburg*, 744 F.2d 1060 (4th Cir. 1984); *In re Graham*, 122 B.R. 447, 451 (Bankr.M.D.Fla. 1990). Davis acknowledges he prepared this document and that he sent it to Malta. Having

both prepared it and used it, Davis cannot deny that this was his financial statement.

8. The Statement is materially false or misleading. A financial statement is "materially false" under Section 523(a)(2)(B)(i) when it is substantially inaccurate, and the information would have had an affect on the creditor's lending decision. *In re Bogstad*, 779 F.2d 370, 375 (7th Cir. 1985); *In re Jordan*, 927 F.2d 221 (5th Cir. 1991). This Statement is materially false or misleading because it overstates the values of the listed assets by at least \$125,000, on a stated net worth of \$600,000. Because of the amounts involved, Davis had to know these values were inaccurate. Perhaps, this was puffing, but it is substantial, and intentional. One can infer an intent to deceive as to these values.

9. Malta also says the Statement was intentionally misleading because it failed to disclose that Ms. Davis was either the owner or co-owner of several of these assets. Here, the undersigned disagrees.

10. Certainly, misrepresentation of ownership of assets and the failure to divulge the true ownership interests is 'material falsity' for purposes of Section 523(a)(2)(B). *In re Winfree*, 34 B.R. 879, 884 (Bankr.M.D.Tenn. 1983); *In re Rodriguez*, 29 B.R. 537, 539 (Bankr.E.D.N.Y. 1983)).

11. However, this Statement was not intended by Davis to be a complete, detailed statement of his individual assets. Rather, this appears to be an informal, thumbnail sketch of his family's finances. This is suggested by Davis's testimony and the document itself.

12. In the first place, Davis's uncontradicted testimony is that he told Malta that the Statement included his wife's property at the time it was given. There can be no material falsity or an intent to deceive as to disclosed information.

13. Since Davis' statement is self-serving, it should be viewed with some skepticism. However, the informality of the Statement supports his contention. This is a handwritten, unsigned document. The date on the Statement is wrong--by a year. It is not prepared on Malta's form but on a bank form. Malta is given only a copy, not an original. Nothing about the Statement suggests completeness, or reliability. Clearly, this is not the product of careful deliberation. It is not a formal statement of the type used when one applies for a bank loan. Rather, this is simply a quick listing of assets.

14. Having told Malta that the Statement included his wife's assets, it was not false, or intended to be for this reason. Davis may have intended to deceive Malta as to the values of the listed assets but not as to their ownership.

15. Malta must also demonstrate in this action that it actually relied on this Statement, and that this reliance was reasonable. 11 U.S.C. § 523(a)(2)(B). *In re Broyles*, 55 F.3d 980, 983 (4th Cir. 1995). This it cannot do.

16. First, Malta was not entitled to rely on the Statement, because it was not a condition to the loan. A prerequisite to reasonable reliance is showing that the debtor was under a duty to furnish a financial statement as part of the credit transaction. *In re Martin*, 761 F.2d 1163 (10th Cir. 1995). Here, there was no such requirement. In fact, there appears to have been no discussion between the parties whatsoever about a financial statement.

17. Even if this was not the case, it is clear that Malta did not rely on this Statement to its detriment, for several reasons. One, Davis had informed Malta that Ms. Davis' assets were in the Statement. Malta could not have reasonably relied upon the Statement to the contrary of what it knew.

18. However, even as a family financial statement, there is no demonstrated reliance in this case. Nothing in the record suggests that Malta gave any consideration to Davis (or his wife's) finances prior to December, 1997.

19. Third, Malta's lack of reliance on the Statement is demonstrated by the parties' silence on this subject during

their negotiations. This was a difficult workout. The negotiations took months. Both sides were represented by lawyers. Their negotiations were memorialized in several written offers and counteroffers. None mention this Statement. Also, when a deal was reached, it was set down in a formal legal agreement, complete with Security Agreement and Personal Guaranty. While that Agreement contains a merger clause, there is no mention of the Statement in it.

20. Even if Malta had relied on the Statement, that reliance was not reasonable. One doubts that it would ever be reasonable for a commercial lender to rely on an unsigned, handwritten photocopy. However, the way Malta treated this document in this case would not be reasonable.

21. For example, Malta did not object to the form of the Statement when it was given or in the future. Malta never requested that the copy be replaced with an original, signed statement. It never asked for an updated Statement. As noted, it didn't even know that the copy in its file was not a signed original until after Charlotte Door shut its doors. This document was not something Malta really cared about. It was merely a paper in Malta's file, and until Davis filed bankruptcy, it had little or no significance.

22. The Court's conclusion is that Malta wanted Davis' personal guaranty for whatever good it would do (moral suasion, perhaps), but it was not relying on any representation of a personal net worth in extending credit. Rather, it was relying on its debt being collateralized and a repayment plan being enacted by Charlotte Door. Davis' actual personal finances were not considered.

23. Moreover, had Malta thought about it, it had reason to doubt the accuracy of this Statement. Malta's rep, Steve Love, knew Davis socially. Love had been over to Davis' house for dinner and knew Davis was married. If Malta was relying on this Statement, it would have known to ask about title to such a significant asset as Davis' house.

24. Finally, Malta could not, and did not, reasonably rely on this document after it declared the Agreement in default in December, 1997. By that date, Malta was aware that (1) Davis lacked the personal ability to contribute to paying Charlotte Door's debt that month; (2) the Statement included his wife's assets; and (3) Ms. Davis was not willing to personally guarantee its debt. At this point, there was no question that the Statement was not an accurate depiction of Davis' finances.

25. However, and despite having information that would tell it that further credit extensions were perilous, Malta continued

to extend credit to Charlotte Door through 1998. In doing so, its entire debt rolled over. All of the debt owed at the date of Davis' bankruptcy, was incurred in 1998 - after the default.

26. Knowing this, these further extensions of credit cannot be said to be in reasonable reliance on the Statement. "Reasonable" reliance...surely does not mean that a creditor may "assume the position of an ostrich with its head in the sand and ignore facts which were readily available to it." *In re Bogstad*, 779 F.2d 370, 372 (7th Cir. 1985)

27. Certainly, Malta had reasons for continuing to give Charlotte Door credit. These could include trying to keep its own sales up; hoping to avoid a shutdown (and subsequent non-payment by Charlotte Door, or even just trying to help an old customer just as it had done since 1996.) However, it is clear that in continuing to ship product in 1998, Malta was not relying on Davis' personal financial statement.

In sum, the Statement contains inflated asset values which are materially false or misleading. Davis probably intended this, but he did not mislead Malta about title to these assets. In any case, Malta did not rely on that Statement in extending or renewing credit. The debt is dischargeable.

Based upon the foregoing, Malta's Objection to Dischargeability is OVERRULED.

SO ORDERED.

This the ____day of August, 2001.

U.S. Bankruptcy Judge